AUD
Section 4: Reporting
Key for guide:
Financials = Financial Statements: B/S, I/S, Statement of Cash Flow, Statement of OE, OCI, Notes.

Module covers audit reporting. Knowledge of reports is tested on every examination. Most questions relate to audit reports some of them will relate to other types of reports that CPAs issue.

A. Financial Statement Audit Reports – General

1. Overall issues
    a. Forms of association – think of four primary forms of accountant association with information
        (1) Examinations – (audits, in the case of financial statements) provide a positive opinion with reasonable assurance on whether assertions follow the appropriate criteria. The unqualified report for financial statement audits include three paragraphs (intro, scope, and opinion)
        (2) Reviews - provide a reports that includes limited assurance. Limited assurance (negative assurance) because the phrase "I am not aware of any material modificiations that should be made" is included.
            (a) First paragraph states that a review in accordance with AICPA standards was performed. The second paragraph indicates the limited scope of the review and the third paragraph provides limited assurance.

(b) The procedures are largely limited to internal inquiries and analytical procedures and are thus significantly more limited than an examination.

(3) Agreed Upon Procedures – result in a report that provides a summary of findings. Because agreed upon procedures will ordinarily be less in scope than examination, the report disclaims a positive opinion on the financial statements.

(4) Compilations – considered an accounting service (not attestation) because no assurance is provided in the report. The first paragraph states that a compilation in conformity with AICPA standards has been performed, the second staes that no opinion or assurance is provided.

b. Restricted use reports v. general use reports (AU 532). – Either restricted use or general use.

(1) Restricted use reports – are intended solely for specific parties. Ordinarily specified parties are those parties to the agreement (management, BOD, Audit Committee, others within org, and sometimes regulatory agencies): the following three circumstances result in a restricted-use auditors' report and should be used.

(a) The subject is based on criteria in contractual agreements or regulatory provisions that are not in accordance with GAAP or another comprehensive basis of accounting

(b) Agreed-upon procedures engagements

(c) "By-products" of an audit ex: (internal control reportable conditions letters [AU 325] and communications with audit committees [AU 380])

(2) An Auditors report that is restricted should contain a separate paragraph at the end of the report that includes

(a) A statement that the report is intended solely for the information and use of the specified parties

(b) An identification of the specified parties to whom use is restricted

(c) A statement that the report is not intended to be and should not be used by anyone other than the specified parties.

c. General Use audit Reprots – are not restricted for specific parties

(1) These reports are on information that is ordinarily understandable by a broader set of individuals than is the information reported upon in restricted-use reports.

(a) Ex: Audit reports on financial statements prepared in accordance with GAAP provide an illustration of what is ordinarily a general-use report.

2. Financial Statement audit Reports – nonpublic companies

a. Key details (Paragraph One)

(1) Paragraph One

(a) Title ("Independent" must be in title)

1] Independent Auditor's Reports

(b) Addressee (company, board of directors and / or stockholders – not management)

1] To: Board of Directors and Stockholders

(c) Introductory Paragraph

1] We have audited

2] Client's financial statements (statements listed)

a] Note: SFAS 130 establishes standards for the reporting and display of comprehensive income and its components when a full set of financial statements is being issued. While it does not require a specific format, the statement provides illustrations that display comprehensive income and its components in three manners.

i. A separate statement

ii. As an add-on to the statement of income

iii. Integrated with the statement of changes in equity

b] When a separate statement of comprehensive income is presented a]. above, the introductory paragraph of the auditor's report should refer to that statement

3] Financial statements are the responsibility of management

4] The auditor's responsibility is to express an opinion

(2) Scope Paragraph (Two)

(a) Audit conducted in accordance with US GAAP

(b) Those standards require that we plan and perform audit to provide reasonable assurance that statements are free from material misstatement.

(c) Audit involves

1] Examining, **on a test basis,** evidence supporting amounts and disclosures

2] Assessment of accounting principles

3] Assessment of significant estimates

4] Evaluation of overall presentation

(d) Audit provides reasonable basis for opinion

(3) Opinion Paragraph (Three)

(a) In our opinion

(b) Statements present fairly per US Generally Accepted Accounting Principles

(4) Manual or printed signature (Firm Name)

(5) Date (normally last day of fieldwork)

b. Remember that GAAP standards include four reporting standards (GAAP, Opinion, Disclosure, Consistency – the GODC mnemonic presented in the overview section). Read 410, 411, and 431 – note that 'present fairly' in the opinion paragraph is

normally to be interpreted within the framework of GAAP. That is, if financial statements are in conformity with GAAP, they normally are presented fairly. Nevertheless, there may be unusual circumstances in which a Generally accepted accounting principle may cause the financial statements to be misleading (new legislation); in such a case the principle is not to be followed.

c. Section 411 addresses the issue of the authority of various sources of GAAP, the section established a 4 level hierarchy of "established accounting principles).
   (1) Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 of the Code of Professional Conduct (FASB and GAS) – we refer to this category as **authoritative body pronouncements**
   (2) Pronouncements of bodies composed of expert accountants, exposed for public conduct
   (3) Pronouncements of bodies composed of expert accountants, not exposed for public comment
   (4) Widely recognized practices and pronouncements
   (5) Other accounting literature

Category	*Nongovernmental Entities*	*State and Local Governments*	*Federal Governments*
A. Authorities Body Pronouncements	-FASB Statements and interpretations -APB Opinions -AICPA Accounting Research Bulletins	-GASB Statements and Interpretations -FASB and AICPA pronouncements applicable by a GASB Statement or Interpretation	-FASB Statements and Interpretations -AICPA, FASB, GASB pronouncements made applicable by a FASB statement of Interpretation
B. Pronouncements of Bodies composed of expert accountants, exposed for public comment	-FASB Technical Bulletins -AICPA Industry Audit and Accounting guides and statements of position (cleared by FASB)	-GASB technical bulletins -AICPA industry audit and accounting guides and statements of position (cleared by GASB)	-FASB technical bulletins -AICPA industry audit and accounting guides and statements of position (cleared by GASB)
C. Pronouncements of Bodies composed of Expert accountants, *not*, exposed for public comment	-Consensus positions of the FASB emerging issues task force -AICPA practice bulletins (cleared by FASB)	-Consensus positions of the GASB emerging issues task force -AICPA practice bulletins (cleared by GASB)	Technical releases of the Accounting and Auditing policy Committee of the FASB AICPA practice bulletins (Cleared by the FASB)
D. Widely Recognized Practices and Pronouncements	-FASB staff questions and answers -AICPA accounting interpretations -Widely accepted industry practices	-GASB staff questions and answers -Widely accepted industry practices	- FASB staff implementation guides -Widely accepted federal government practices

E. Other Accounting Literature	-FASB Concepts statements -APB Statements -AICPA Issues papers and technical practice aids -International accounting standards committee statements -GASB statements, interpretations, and technical bulletins -Pronouncements of other professional associations or regulatory agencies -Accounting textbooks, handbooks, and articles	-GASB Concepts statements Pronouncements in (A) through (D) of nongovernmental hierarchy not specifically made applicable -APB Statements -FASB concepts statemetns -AICPA Issues papers and technical practice aids -International accounting standards committee statements -Pronouncements of other professional associations or regulatory agencies -Accounting textbooks, handbooks, and articles	-FASB concepts statements -Pronouncements in (A) through (D) of GASB and FASB not specifically made applicable -FASB and GASB concepts statements, AICPA issues papers, and technical practice aids -International accounting standards committee statements -Pronouncements of other professional associations or regulatory agencies -Accounting textbooks, handbooks, and articles.

d. In cases of conflict between the accounting treatment suggested by the categories, the higher category prevails over the lower ones. For conflicts within a category the treatment most closely approximating the transaction's economic substance prevails

e. Section 431, addresses the adequacy of financial statement disclosures. Disclosures are to be regarded as reasonably adequate unless otherwise stated in the audit report. When the auditor issues a qualified or an adverse opinion, the report should provide, if practicable, the information causing the departure from an unqualified report. Thus, if the client omits information in the notes concerning a loan agreement's restrictions of future dividends, the auditor would provide the additional information.

   (1) However, if the client omitted a statement of cash flows, the auditor would not be required to prepare it, since if is not practicable to easily and directly obtain this information from the client's records.

f. As indicated earlier in this module, the date of the audit report is usually the last day of fieldwork. AU 530, discusses an often-tested exception to this rule. When a subsequent event requiring note disclosure has occurred after the close of fieldwork but prior to the issuance of the audit report, the auditor may either dual date the report or change its date to that of the subsequent event.

   (1) Better to double date so that auditor is not responsible for other items that have happened since the end of initial report and this new event.

g. AU 530 also address the proper date of an audit report when a CPA is asked to either furnish additional copies of a previously issued report or to reissue a previously

issued report (for inclusion in a report filed with the SEC). in both circumstances, the date is not normally changed from that ordiniarly used

(1) However, if the CPA has become aware of an event requiring note disclosure (contrasted to adjusting entry), the financial statements should disclose the event in a separate unaudited note to the financial statements.

(2) The note should be captioned in a manner such as “event (unaudited) subsequent to the Date of the Independent Auditor’s report,” when the event is such that the financial statements require adjustment, the auditor should reissue the report as dual dated

3. Financial Statement Audit Reports – Public Companies.

   a. The SOX act of 2002 created a requirement for an integrated audit that procides assurance about the fairness of financial statements and about the effectiveness of internal control over financial reporting – the internal control module discusses audit reports on internal control. The audit report on financial statements is different from that of a nonpublic company in the following ways.

      (1) The report includes the title “report of Independent Registered Public Accounting Firm”

      (2) The report refers to the standards of the PCAOB rather than GAAP standards

      (3) The report includes a paragraph referring to the auditor’s report on internal control (this reference is obviously only required when the reports on the financial statements and internal control are separate)

      (4) The report should contain the city and country of the office that issued the report.

B. Financial Statement Audit Reports – Detailed

1. Circumstances resulting in departure from the auditor’s standard report

   a. The AICPA does not present a list of necessary conditions for an auditor to render a standard, unqualified report. The approach is one of presenting circumstances that may require departure from the standard report. These situations may be divided into circumstances requiring additional explanatory language to be added to an unqualified report, and those while result in other than an unqualified report as follows

   b. Opinion Based, in part, on report of another auditor (AU 543, 508)

      (1) Opinions based, in part, on the report of another auditor may differ from the standard report.

         (a) The situation arises when two or more auditors are involved in the audit of a single entity. (Ex: one CPA firm audits the entire firm except for a subsidiary in a distant location)

1] The auditor who audited the single subsidiary will generally issue a report on the subsidiary.

2] The auditor who audited the remainder of the firm could give a report on that portion of the entity examined.

3] However there will generally be a preference (and indeed often a legal requirement) for an audit report on the overall entity.

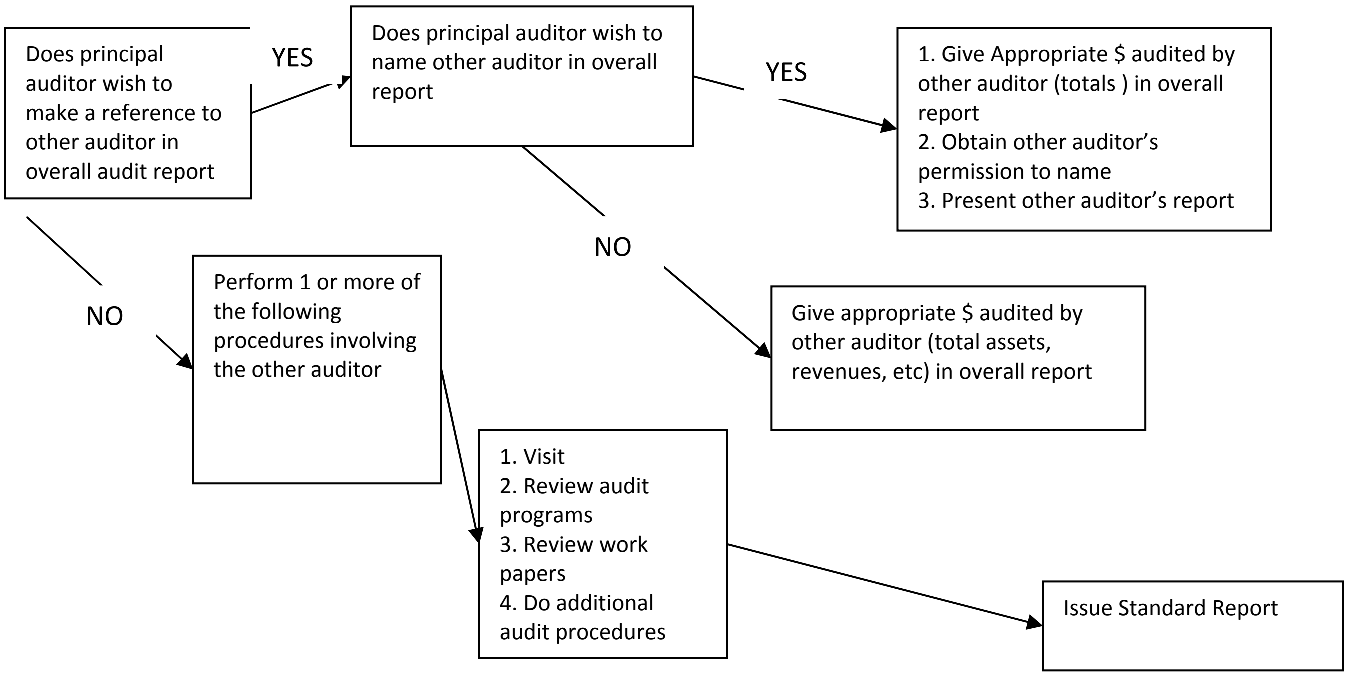
(2) The overall audit report must be signed by the principal auditor, (designated based on the materiality of the portion of financial statements examined, knowledge of the overall financial statements, and the importance of the components audited. Principal required to:

(a) Make inquiries regarding the other auditor's reputation (contact AICPA, state society of CPAS, other practicioners, bankers)

(b) Obtain a representation from the other auditor concerning indepdence

(c) Ascertain that the other auditor knows US auditing standards, SEC standards (if appropriate) and knows that the financial statements he or she audited are a component of, and to be included with, the financial statements on which the principal auditor will report.

(3) If the results of any of the above inquiries are unsatisfactory, the principal auditor must either modify the overall audit report (qualify or disclaim), or audit the component themselves. If the results of the inquires are satisfactory, the following summarizes the principal auditor's required decisions and responsibilities.

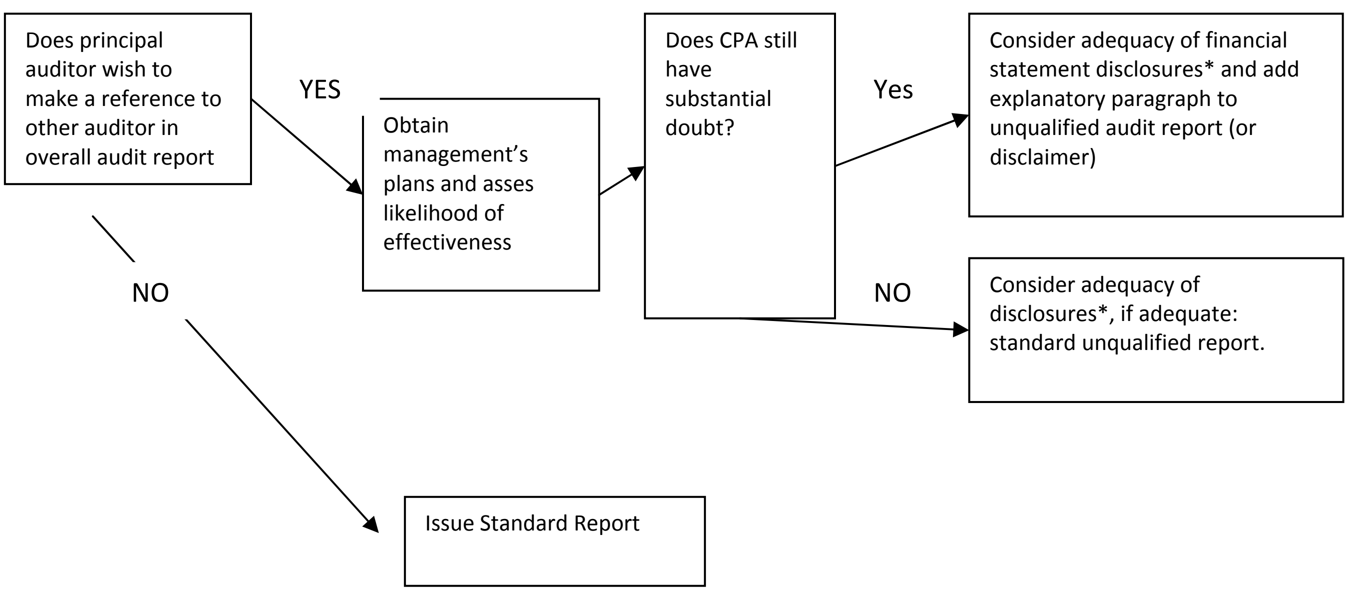


(4) The decision to make reference to the other auditor indicates divided (or shared) responsibility between auditors and is not considered an audit report qualificiation. The decision not to make a reference to the other report indicates that the principal auditor assumes responsibility for the work of the other auditor (reasons including:)
   (a) The other auditor is an affiliate of the principal auditor
   (b) The principal auditor hired the other auditor
   (c) Portion audited by the other is not material
   (d) Other miscellaneous reasons as the principal auditor (or client) desires.
(5) Finally note that in situations in which the other auditor's report is other than unqualified, the materiality of the matter (causing a departure from the standard report of the other auditor) to the overall financial statements determines whether the principal auditor's report must be modified

c. Unusual circumstances requiring a departure from promulgated GAAP (AU 508)
   (1) This circumstance occurs when an auditor agrees with a new client that a departure from GAAP is justified due to unusual circumstances (new legislation for a type of transaction). If you follow GAAP there is misleading financials.
   (2) Situation is not: ex: when client reports fixed assets @ current values vs. historical cost; inflation hasn't been unusual in that it has affected the financial statements of all compaies.

(3) When unusual which would result in misleading statements, GAAP should be departed from and the auditor should issue an unqualified report with an explanatory paragraph describing the departure.

d. Substantial doubt about ability to remain a going concern (AU 341)
   (1) Auditor must judge entitys ability to remain a in business – a period not to exceed one year from the date of the financial statements
   (2) C. 17 in evidence – audit is not required to include procedures aimed soley at identifying a going concern question, results from procedures performed through the audit should be evaluated to determine whether they suggest substantial doubt
   (3) If doubt – auditor considers management's plans for dealing with the conditions and events causing the uncertainty are likely to negate the problem.
      (a) If doubt still exists after evaluating management's plans: should either
         1] Issue explanatory paragraph to unqualified (following opinion)
         2] Disclaim an opinion.
      (b) In either case report must include "substantial doubt" and "going concern".
      (c) If analysis shows that substantial doubt does not exist, he or she must still consider the adequacy of financial statement note disclosures related to the matter.



- If disclosures are not adequate, a departure from GAAP exists which may lead to qualified or adverse opinion

e. Inconsistency in application of GAAP (AU 420, 508)

(1) A change in accounting principle that has a material effect on the comparability of a company’s financial statements ordinarily results in a report with an unqualified opinion followed by an explanatory paragraph. Review APB 20 on accounting changes.

(2) General rule: *changes in accounting principle* result in the addition of explanatory language, while changes in accounting *estimate*, *corrections of clerical errors, and minor reclassifications of accounts* from one year to the next do NOT.

   (a) Changes in business entities and changes among carrying bases (cost, equity consolidated) for continuing subsidiaries result in explanatory language; creation, cessation, purchase, or disposition of subsidiaries do not result in explanatory language.

(3) Consistency pertains to the accounting treatment of items **between periods**.

   (a) In comparative reports for changes that are not accounted for by retroactive restatement, the explanatory paragraph is retained as long as the year of change is presented. Retroactive changes require the explanatory paragraph only in the year of change.

(4) Consistency matters:

   (a) Differing accounting principles may be used for different portions of an account. For example: a client may choose to use FIFO for valuation of a portion of its inventory and LIFO for the remainder. Similarly, for fixed assets, differing depreciation methods may be used for different classes (types) of assets

   (b) A change that is immaterial this year, but is expected to become material in the future, *does not* result in explanatory language if the client has properly disclosed it in the notes to the financials

   (c) If the auditor does not concur with a change in principle, or if the change has not been properly accounted for, a qualified or adverse opinion is required because this represents a departure from GAAP

   (d) The audit report does not mention consistency when there has been no change in principle.

(5) Frequent changes in principle relating to consistency.

<u>*Type of Change*</u>	<u>*Consistency explanatory paragraph*</u>
I. Change in accounting Principle	
a. GAAP to GAAP	Yes
b. Non-GAAP to GAAP	YES
c. GAAP to non-GAAP	YES*
d. For newly acquired assets in an existing class	

of assets (whether a, b or c above) e. For a new class of asset (whether a, b, or c, above)	Yes No
II. Change in Accounting Estimate a. Judgmental adjustments b. Inseparable estimate and principle change	 NO Yes
III. Change in entity a. Changes between carrying basis (cost, equity, or consolidated) b. Pooling c. Changes in subsidiaries (creation, cessation, purchase, disposition).	 Yes No No
IV. Correction of an Error a. Error in principle (I.b.above) b. Error not involving application of a principle	 Yes No
V. Change in Statement Format a. Classifications and reclassifications **Note that section I.c. will also result in a departure from GAAP exception.*	 NO

f. Certain circumstances affecting comparative financial statements (AU 508)

(1) When comparative statements are issued (financials for two to or more periods) the auditor must report on the statements for *all years presented*. One overall report, dated as of the last day of fieldwork for the most recent audit, addressing the years presented, is issued. Two major situations may result in an *unqualified report with explanatory language*

(a) An opinion on the prior period financial statements may differ from the opinion previously issued.

1] Auditor may have qualified an opinion on the prior period because of a departure from GAAP, and the prior period statements may be restated in the current period to follow GAAP

2] The auditor's updated report on the statements should indicate that the statements have been restated and should express an unqualified opinion with respect to the restated statements.

3] Whenever an updated report has an opinion different from that previously expressed, the auditor should disclose all substantive reasons for the different opinion in a separate explanatory paragraph preceding the opinion paragraph. Should disclose

a] The date of the previous report
b] The type of opinion previously expressed
c] The circumstances causing the auditor to express a different opinion
d] That the updated opinion is different from the previous opinion.

(b) When a predecessor auditor has examined the prior period statements, a decision needs to be made as to whether the predecessor's report is to be reissued. If the report is **not** to be reissued, the successor auditor's report should indicate in the introductory paragraph.
a] That the financial statements of the prior period were examined by other auditors
b] The date of the predecessor's report
c] The type of report issued by the predecessor
d] The substantive reasons therefore, if it was other than a standard unqualified report.

2] If the predecessor;s report is to be reissued, the predecessor should read the current statements, compare the prior period statements to the current statements, and obtain from the successor a letter of representation as to whether any material matters concerning the prior period statements have arisen
a] Regardless of whether the predecessor's report is being reissued, the opinion paragraph of the successor auditor's report refers only to the second year.

g. Required quarterly data for SEC reporting companies (AU 722)
(1) Certain SEC reporting companies are required to include unaudited quarterly information in their annual reports or other documents filed with the SEC that contain audited financial statements. Auditors are engaged to perform review procedures either at the conclusion of each quarter or at the end of the year when the information is included with the annual information.
(2) When dealing with the annual financial statements, omission, misstatement, or auditor inability to review the quarterly information all lead to inclusion of an explanatory paragraph in the annual audit report.
(3) Be aware that the information is to be reviewed, not audited. Therefore its misstatement will **not** lead to a qualified or an adverse opinion.

h. Supplementary information required by the FASB or GASB (AU 558)
(1) This information is treated identically to the required quarterly data for SEC reporting companies (see prior section).
(2) Omission, misstatement, or auditor inability to review the information will lead to the inclusion of an explanatory paragraph in the audit report

i. Other information in a document containing audited financial statements (AU 550-552)
   (1) Section 550 deals with other information in documents containing audited statements.
      (a) Refers to the case where the audited financial statements are included in a published annual report that includes other information (graphs, president's letter, pictures).
      (b) The auditor is required to read the annual report and note any inconsistencies between the financial statements and the other information provided. If the audited financial statements are inconsistent with the other information, one or both of the following must be true
         1] Financial statements are incorrect – this will lead to a qualified opinion or an adverse opinion since it is a departure from GAAP (Section k.)
         2] Other information is incorrect – this will lead to an unqualified report with an explanatory paragraph, and/or withholding use of the audit report and/or withdrawal from the engagement.
      (c) Finally the auditor may note no inconsistency but may believe that the other information *seems* incorrect. Auditor should discuss matter with client, consult with other parties such as legal counsel, and use judgment as to the resolution to the matter.
   (2) Section 551 deals with reporting on information in auditor submitted documents. When an *auditor submits a document* containing audited financials they have the responsibility to report on *all* of the info included in the document.
      (a) Should either disclaim an opinion on the additional info, or audit the info and issue an opinion on it.
      (b) If info is to be audited, the measure of materiality is in relation to financials taken as a whole
      (c) The disclaimer or opinion may either be included in the overall audit report or presented as a separate report.
   (3) Section 552 addresses the situation for which selected financial data, derived from audited financial statements, are presented in a client prepared document. (Summary of financials in the annual report), that also include audited financials.
      (a) The auditor may report on only the financial data that is derived from the audited financial statements.
      (b) An explanatory paragraph is added in which the auditor states whether the selected financial data are fairly stated in all material respects in relation to the financials.

j. Emphasis of a matter (AU 508).

(1) The auditor may wish to emphasize a matter (through adding an explanatory paragraph) regarding the financial statements, but nevertheless intend to render an unqualified opinion.
(2) Ex: Cases in which the entity is a component of a larger entity, or which significant related party transactions exist, or the auditor wishes to draw attentionto an important subsequent event.
(3) Such information is included in an explanatory paragraph.
(4) Untill 1996, significant uncertainties affecting the financial statements (significant lawsuit, which nevertheless did not raise a question concerning going concern status, were considered a distinct circumstance that might result in the addition of an explanatory paragraph to an audit report.
    (a) Standards relating to uncertainty modifications were eliminated, and now an auditor may wish to emphasize an uncertainty through inclusion under the emphasis of a matter paragraph.